GTE has also suggested that competitors have additional protection from price squeezes because "[t]his outcome is more unlikely because many states require UNEs to be price at long run incremental costs."[36] GTE misses the point here. The price squeeze problem is not just about how UNE prices are determined. As the Commission indicated in a previous evaluation of ILEC long-distance affiliates and price squeezes, "[i]t is this unprofitable relationship between the input prices and the affiliate's prices; and not the absolute levels of those prices, that defines a price squeeze."[37] Regardless of what the UNE prices are, if retail DSL prices assume lower UNE prices or no UNE prices at all, new entrants will not be able to compete effectively.

C. Unless Respondents' DSL Tariffs Contain Rates That Reflect UNE and Input Costs, the Commission Should Reject Those Tariffs and Allow Respondents' to Choose Either to Lower Input Costs or Cease the Cross-Subsidization of Their DSL Services

In addressing whether the Commission should defer its authority over Respondents' DSL services to the states, the ILECs vaguely point to state and federal commissions, as if to say that all will be well if regulators just do their jobs.[38] While Respondents correctly conclude that the Commission should retain its authority over DSL tariffs, Respondents' answers do not explain how a Commission decision to retain authority over DSL tariffs will adequately lessen the ability of ILECs to affect a price squeeze. Yet analysis of DSL rates for price squeeze behavior is not difficult. Specifically, the Commission can lessen the price squeeze concerns of new entrants by

---

[36] GTE Direct Case at 25 fn. 67.

[37] NYNEX Corporation and Bell Atlantic Corporation, Petition For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd 19985, 20045 ¶ 117 (1997). The Commission was responding to the concerns of long-distance providers that ILECs would create a price squeeze in the long-distance market by charging higher access fees to long distance competitors than to their affiliates offering long-distance services.

[38] BellSouth argued that "no evidence exists that any [state] commission has been impeded in carrying out its respective regulatory functions," and moreover that deferring to the states would "displace the dual regulatory scheme" established by the Act. BellSouth Direct Case at 17-18. Pacific Bell argued that it "fully expects that [the price squeeze concerns] will be raised before the appropriate regulatory body," and moreover "the Commission doesn't lack "the necessary expertise or tools in which to explore and address any legitimate price squeeze issue that might arise." Pacific Bell Direct Case at 16.

evaluating retail rates in the ILECs' DSL tariffs alongside the state-approved cost of UNE inputs needed to provide DSL-based service, and determine whether the rates and costs are inconsistent, and thus effecting an illegal price squeeze.

There are two remedies available to address an illegal price squeeze—ordering a reduction in UNE and collocation rates, and requiring that retail rates reflect all input costs. However, as the Eighth Circuit's decision on UNE rate-setting jurisdiction remains in effect pending Supreme Court review,[39] the Commission currently lacks the authority to reduce the cost of UNEs and collocation. Thus, in the event that the Commission determines that the ILECs' DSL tariffs would effect an impermissible price squeeze, the Commission should simply reject those tariffs and allow the ILEC Respondents to choose either to lower input costs or cease cross-subsidization of their DSL services. In this way, the Commission need not delve into the merits of the state costing proceedings, methodologies or data. Nor would the Commission need to defer to the states to set new UNE rates, because it would exercise its interstate jurisdiction and provide ILECs with a voluntary choice on how to rectify the inconsistency between interstate DSL rates and state-based UNE prices. The Commission can simply condition approval of the ILECs' DSL tariffs on elimination of the price squeeze, either through reductions in UNE prices or, if the ILEC prefers, increases in their interstate DSL rates in order to cover all loop and other input costs.

The ILEC Respondents' arguments supporting their costing methodologies for retail DSL services are suspect. GTE contends that "[a]llocating a greater portion of loop costs to the ADSL service would only force subscribers to pay a higher, noncompetitive rate for their ADSL service, with little possibility of any corresponding reductions in local rates."[40] However, this

[39] Iowa Utilities v. FCC, 120 F.3d 753 (8th 1997).
[40] GTE Reply at 18.

argument fails because local rates need not remain static if a greater portion of loop costs are allocated to the DSL. For instance, the underlying local rates could be based on the extent to which local services utilize the local loop, for instance based on relative use. In stark contrast, however, the ILECs have assumed no loop costs in their retail DSL rates.

GTE justifies the exclusion of all loop costs by stating that "[s]ince local exchange rates are largely averaged throughout a study area, an additional allocation of loop cost to the relatively small number of new ADSL customers would have a de *minimis* effect on local exchange prices."[41] This is essentially an argument that DSL need not bear any allocation of loop costs, despite use of the loop both by voice and DSL services, because current demand for local exchange services exceeds demand for DSL. That is a non sequitur. Moreover, the effect of loop allocation on local exchange prices, whether or not de *minimis*, is irrelevant. They relevant question is the effect on the DSL prices, and how to ensure that DSL retail prices accurately reflect the inputs necessary to produce DSL services. It is particularly important that the Commission focus on the effect on DSL rates because of the revolutionary potential of DSL technology, and the opportunities that new entrants have to participate in a market not yet dominated by the ILECs. Until newer technologies develop, DSL technology could become the preferred technology for communication delivery, and could upset traditional concepts that have classified telecommunications services as basic or enhanced, or interstate and intrastate. Allowing anticompetitive rates could sideline new entrants in that revolutionary process.

Finally, GTE attempts to argue that, even if price squeezes are a concern, GTE should not have to include its loop costs in its DSL tariff rates because "[s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates."[42]

---

[41] GTE's Direct Case at 18 n.53.
[42] GTE Reply at 18.

Moreover, GTE argues that its tariff prices do not create an impermissible price squeeze because its ADSL retail prices "reflect the incremental cost of providing ADSL services," and that "[p]ricing for new regulated services based on incremental costs is completely consistent with the Commission's new service pricing rules."[43] BellSouth similarly argues that "since [m]ost facilities available from a LEC as a UNE are multi-use facilities capable of supporting multiple services, where such facilities are used in the provision of services . . . the revenue derived from all of the services provided that employ these multi-use facilities must recover the costs of those facilities."[44]

What Respondents are advocating here is classic anticompetitive behavior. Respondents are cross-subsidizing their services in order to shift the majority, if not all, of the input costs from competitive services to monopoly services guaranteed to provide a rate of return that will meet those additional costs. Under the ILECs' reasoning, they could price their retail DSL services on the assumption of zero loop costs. This is not an economically rational result. By excluding UNEs and collocation, the inputs that Respondents have included in their cost recovery represent only a shell of Respondents' DSL services. While DSL equipment enables Respondents to provide sophisticated services, the access to UNEs and collocation is still the central component needed to provide DSL services. Thus, to allow Respondents to exclude UNE and collocation costs from their retail rates is anticompetitive and impermissible.

D. Because the Commission's Proposed Affiliate Scheme for ILEC Advanced Services Will Reduce the ILECs' Ability To Effect an Illegal Price Squeeze, Deference to the States Would Be Premature

In a separate but related proceeding, the Commission has outlined a proposal that would allow ILECs to offer DSL services through separate affiliates in order to encourage the deploy-

---

[43] GTE Reply at 17-18.
[44] BellSouth Reply at 10.

ment of advanced telecommunications services.[45] Under this separate affiliate scheme, any affiliate providing DSL services will have to buy UNEs and collocate under the same terms that competing providers currently operate, thus forcing the ILECs to participate on a level playing field. In such a situation, the DSL solutions offered by the affiliates will be more likely to derive from the same wholesale input costs as competing providers.[46]

ACI and FirstWorld do caution that the affiliate option will not reduce and or eliminate the opportunity for imposing price squeezes. An ILEC, even in an affiliate situation, would still have the opportunity to blur the lines between ILEC and affiliate on UNE and collocation costs, thus offering their affiliates prices that are lower than those offered to competitors. Since the effectiveness of the affiliate scheme as a check against price squeezes depends on affiliate safeguard that the Commission has yet to determine, any action by the Commission to defer its authority over Respondents' DSL tariffs to the states, as such action would be premature.

III. CLASSIFYING RESPONDENTS' SERVICES AS INTERSTATE NEITHER INVOKES MUTUAL COMPENSATION CONCERNS NOR DIMINISHES ILECs' OBLIGATION TO PROVIDE UNEs, INCLUDING DSL-CAPABLE LOOPS, UNDER THE ACT

Some parties have erroneously argued that classifying and tariffing Respondents' services as interstate would allow ILECs to avoid their obligations to pay mutual or reciprocal compensation[47] to CLECs for the origination and termination of "dial-up" calls from end users to ISPs.[48]

---

[45] Advanced Services NPRM ¶83-88.

[46] Implementation of the Non-Accounting Safeguards of Sections 271 and 271 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rulemaking, 11 FCC Rcd 18877 (1996). "If a BOC charges its competitors prices for inputs that are higher than the prices charges, or effectively charged, to the BOC's affiliate, then the BOC can create a 'price squeeze.' In that circumstance, the BOC affiliate could lower its retail price to reflect its unfair cost advantage, and competing providers would be forced either to match the price reduction and absorb profit margin reductions or main their retail prices at existing levels and accept reductions in their market shares. If the price squeeze was severe enough and continued long enough, the BOC affiliate's market share could become so large, and the competitors so weakened, that that affiliate could unilaterally raise and sustain a price above competitive levels by restricting its output."

[47] Section 251 of the 1996 Act requires that LECs "establish reciprocal compensation arrangements for the transport and termination of telecommunication services." 47 U.S.C. § 251(b)(5)

This is simply not the case. Rather, as noted above DSL technology can be used to provide both interstate and intrastate services, and in the ILECs' application is used to provision a dedicated special access service. Thus, a finding that Respondents' DSL services are jurisdictionally interstate will not prevent CLECs from collecting mutual compensation in the instances where DSL technology is used in conjunction with UNEs to provide intrastate services. More importantly, a Commission decision to classify these DSL services as interstate special access will obviously have no impact on mutual compensation for switched, dial-up Internet traffic delivered to ISPs over the PSTN, to which the "10% rule" is plainly inapplicable. Consequently, as GTE observes, there is no conflict between classifying DSL services as interstate and the many state commission decisions requiring ILECs to pay mutual compensation on Internet traffic delivered to ISP on a switched basis over local exchange services.[49]

Nor is there any conflict between the classification of these DSL services are jurisdictionally interstate and the ability of CLECs to use unbundled loops and other UNEs for the provision of competing DSL services. The Commission has made clear that UNEs can be used for the provision of either interstate or intrastate services, for instance in the provision of interstate switched access services. At this sensitive point in the development of DSL competition, any ambiguity on this point could provide the ILECs with increased incentives to delay and obstruct interconnection by CLECs, because DSL requires access to unbundled loops, collocation and other UNEs. Therefore, ACI and FirstWorld urge that the Commission expressly reaffirm the obligation of ILECs to provide UNEs, including DSL-capable loops, for the provision of interstate DSL services[50] The Commission has already explained that ILECs must unbundle DSL-

---

[48] ALTS Petition on GTE's ADSL tariff at 9; c*spire communications Petition on GTE's ADSL tariff at 2.
[49] GTE Direct Case at 7
[50] Deployment of Wireline Services Offering Advanced Telecommunications Capability, Memorandum and Order, CC Docket No. 98-147 (rel. Aug. 7, 1998)

compatible loops for use by CLECs in offering DSL services.[51] The final order in these investigations should reaffirm that this unbundling obligation exists regardless of the jurisdictional classification of the DSL services provided by the CLEC, including the use of DSL technology for offering interstate services

[51] Advanced Services NPRM ¶ 53.

CONCLUSION

For all these reasons, the Commission should (i) classify the ILEC Respondents' DSL services as interstate special access; (ii) retain its tariffing authority over interstate DSL services, without deferring to state commissions; (iii) address ILEC DSL price squeezes by rejecting interstate DSL tariffs reflecting retail rates inconsistent with UNE inputs costs, allowing ILECs the choice of either lowering their UNE rates or eliminating the cross-subsidization of their retail DSL services; and (iv) expressly reaffirm the obligation of ILECs to provide UNEs, including DSL-capable loops, for the provision of interstate services.

Respectfully submitted,

ACI CORP. AND FIRSTWORLD COMMUNICATIONS, INC.

By: Lisa Anderson

Jeffrey Blumenfeld
Glenn B. Manishin
Lisa N. Anderson
Stephanie A. Joyce
Blumenfeld & Cohen—Technology Law Group
1615 M Street, N.W., Suite 700
Washington, D.C. 20036
202.955.6300

Counsel for ACI Corp. and FirstWorld Communications, Inc.

Kevin Timpane
Esther H. Rosenthal
FirstWorld Communications, Inc.
9333 Genesee Avenue
San Diego, CA 92121
619.552.8010

Dated: September 21, 1998

CERTIFICATE OF SERVICE

I, Amy E. Wallace, do hereby certify that on this 5th day of October, 1998, that I have served a copy of the foregoing document *by hand delivery and U.S. Mail, postage prepaid, on the following persons:

Amy E. Wallace

*Kathryn C. Brown
Chief, Common Carrier Bureau
FCC
1919 M Street, N.W.
Room 500
Washington, DC 20554

*Judith A. Nitsche
Chief, Tariff and Price Analysis Branch
Common Carrier Bureau
FCC
1919 M Street, N.W., Room 518
Washington, DC 20554

*ITS
1231 20th Street, N.W.
Washington, DC 20036

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W.
Suite 1200
Washington, DC 20036

J. Manning Lee
Teleport Communications Group, Inc.
Two Teleport Drive, Suite 300
Staten Island, NY 10311

*James D. Schlichting
Chief, Competitive Pricing Division
Common Carrier Bureau
FCC
1919 M Street, N.W., Room 518
Washington, DC 20554

*Jane Jackson
Chief, Competitive Pricing Division
FCC
1919 M Street, N.W., Room 518
Washington, DC 20554

John F. Raposa
GTE Service Corporation
600 Hidden Ridge
HQE03J27
Irving, TX 75038

R. Michael Senkowski
Gregory J. Vogt
Bryan N. Tramont
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006

Donna M. Lampert
Frank W. Lloyd
Mintz Levin Cohn Ferris Glovsky & Popeo
701 Pennsylvania Avenue, N.W., Suite 900
Washington, DC 20004-2608

Richard J. Metzger
Association for Local Telecommunications Services
888 17th Street, N.W., Suite 900
Washington, DC 20006

Edward A. Yorkgitis
Jonathan E. Canis
Kelley Drye & Warren
1200 19th Street, N.W., Fifth Floor
Washington, DC 20036

Laura Phillips
Dow, Lohnes & Albertson
1200 New Hampshire Avenue, N.W.
Suite 800
Washington, DC 20036

Barbara A. Dooley
Commercial Internet eXchange Association
1041 Sterling Road, Suite 104A
Herndon, VA 20170

Alan Buzacott
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Michael T. Weirich
Oregon Public Utility Commission
1162 Court Street NE
Salem, OR 97310

Richard M. Rindler
Swidler & Berlin, Chartered
3000 K Street, N.W.
Washington, DC 20007

Cheryl Callahan
New York Public Service Commission
2 Empire State Plaza
Albany, NY 12223-1350

Rodney L. Joyce
Shook, Hardy & Bacon
1101 Pennsylvania Avenue, N.W.
Suite 800
Washington, DC 20004-2615

Steven Gorosh
Northpoint Communications
222 Sutter Street
San Francisco, CA 94108

Anatole Nagy
ATU Telecommunications
600 Telephone Avenue, MS 8
Anchorage, AK 99503

Christine Jines
Pacific Bell
1401 I Street, N.W.
Suite 1100
Washington, DC 20005

Jill E. Morlock
Pacific Bell
Four Bell Plaza
Room 1950.04
Dallas, TX 75202

Robert M. Lynch
Durward D. Dupre
Darryl W. Howard
SBC Communications, Inc.
One Bell Plaza, Rm. 3703
Dallas, TX 75202

Michael K. Kellogg
Evan T. Leo
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.
1301 K Street, N.W., Ste. 1000 West
Washington, DC 20005

Leon M. Kestenbaum
Jay C. Keithley
Marybeth M. Banks
Sprint Corporation
1850 M Street, N.W., 11th Floor
Washington, DC 20036

Jerry Yanowitz
Jeffrey Sinsheimer
Glenn Semow
California Cable Television Association
4341 Piedmont Avenue, P.O. Box 11080
Oakland, CA 94611

James A. Kirkland
James J. Valentino
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
701 Pennsylvania Avenue, N.W., Ste. 900
Washington, DC 20004-2608

Bernarad Chao
Covad Communications Company
3560 Bassett Street
Santa Clara, CA 95054

Thomas M. Koutsky
Covad Communications Company
6849 Old Dominion Drive, Suite 220
McLean, VA 22101